Commonwealth of Massachusetts
Department of Telecommunications and Energy

Investigation into the Provision of Default Service	)	**D.T.E. 02-40**

Reply Comments of the
Competitive Retail Suppliers

I. Introduction

AES NewEnergy, Centrica North America, Green Mountain Energy, and Strategic Energy (together "Competitive Retail Suppliers") submit these reply comments in response to the Department of Telecommunications and Energy's ("Department") June 21, 2002 request for comments.

The initial comments showed little consensus. Indeed, the Department was presented with several radically different proposals for the reform of default service. However, we urge the Department to resist all temptation to try more than one of these different approaches. Adopting different default service regimes in different utility service territories would force competitive suppliers to develop different processes and systems for each territory. This would create barriers and raise costs. Massachusetts needs a single, statewide approach to default service.

In these reply comments, the Competitive Retail Suppliers will: 1) discuss why the Department should strive to create a competitive **retail** market, and not settle for wholesale competition alone; 2) describe our vision for default service; and 3) respond to the specific proposals offered by several of the other parties.

II. The Department should Strive to Create a Competitive Retail Market for All Customers. It should not Settle for Wholesale Competition Alone.

The central challenge before the Department is to enable **retail choice** for **all customers**. In the initial comments, customer representatives as diverse as the Cape Light Compact and the Western Massachusetts Industrial Consumers Group urged retail competition for all.

Cape Light Compact: "Default Service cannot substitute for a retail marketplace . . . Default Service should not be restructured in a fashion which undermines consumer choice and the development of a robust, **retail market that serves all customer classes** and facilitates competition and aggregation." Comments of the Cape Light Compact at 3.

Western Massachusetts Industrial Consumers Group: "[I]t is important that default service pricing and procurement be carefully reviewed to make sure that **all** customers, including large C & I customers, have a properly functioning competitive market." Comments of The Western Massachusetts Industrial Customers Group at 3.

Customer choice is central to electric restructuring. The Department should enable choice for small customers, as well as large, so that they too can realize the benefits of retail competition, including better service, innovative and customized product offerings, and lower prices over time.

The Department should reject the assertion of some parties that, for small customers, retail competition is unnecessary because wholesale competition is enough. See, e.g., Comments of NSTAR Electric at 7.

Indeed, none other than ISO New England ("ISO-NE" or the "ISO"), the non-profit entity responsible for administering the wholesale market, rebutted the claim that wholesale competition alone is sufficient. The ISO explained that a "strong and competitive" retail market is in fact a prerequisite to a properly functioning wholesale market. In other words, if you don't have retail competition, you don't have fully effective wholesale competition either.

> A healthy wholesale energy market is linked to a strong and competitive retail energy market. Without retail customers responding to price signals, the wholesale market may not function properly. Retail customers responding to high-energy prices by reducing their demand can help to temper wholesale energy prices. The reaction to energy prices transforms what might be inelastic demand into demand that is willing and able to curtail consumption if the price becomes too high. This linkage makes the pricing of retail service important to the wholesale market.

ISO-NE comments at 5-6.

The ISO further described two characteristics of today's default service that prevent the development of a competitive retail market and thus prevent the development of fully effective wholesale competition. First, as long as the default service price "does not reflect all the costs of serving and acquiring load," new suppliers will not be able to enter the market and retail competition will not develop. Second, as long as a default service supplier serves a percentage of total utility load rather than actual customers, the supplier has "little or no incentive" to help customers reduce demand when prices are high -- a key factor in tempering wholesale prices. This is because the supplier of a percentage of load has no connection with customers and will receive only a fraction of the benefit of any demand response. ISO-NE comments at 5.[1]

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[1] In this regard, it is not surprising that some ***wholesale*** suppliers support the status quo, and oppose reforms that would lead to a more competitive retail market. See Comments of Duke Energy Trading and Marketing; Comments of Constellation Power Source. The current system benefits those suppliers because it hinders the development of a retail market and the demand response that would keep wholesale prices in check.

III. Competitive Retail Suppliers' Proposal.

In our initial comments, the Competitive Retail Suppliers offered a proposal that would create a competitive retail market for all customers. Importantly, the proposal would address the structural barriers that have prevented retail suppliers from entering the market and making competitive offers.[2] Our proposal has four key elements: 1) include all generation and retailing costs in the default service price; 2) remove the utility from the role of default service provider; 3) make billing competitive; and 4) reform default service pricing.

A. Default Service Prices should include all Generation and Retailing Costs.

In order to enable a competitive retail market, the default service price must include all the costs of providing the service. This is not the case today. As Western Massachusetts Electric pointed out in its comments, "Under the current program, default service customers are essentially paying a wholesale price for a retail service." WMECo Comments at 5.

Several parties to the proceeding have advocated that default service prices include administrative and bad debt costs. See, e.g., Comments of NSTAR Electric at 9; Comments of the Division of Energy Resources at 26 – 32; Comments of Fitchburg Gas and Electric Company at 2 - 3.

While this is a start, it is not sufficient. To enable fair competition, default service prices must include **all** generation and retailing costs, including:

- Administrative costs

[2] It is important to note that the problem in Massachusetts is not, as some have suggested, that small customers have not chosen. See, e.g., Comments of NSTAR Electric at 4. The problem is that those customers **have not even been offered a choice** because the market structure has prevented competitive suppliers from entering the market and making offers.

- Electric supply-related bad debt
- Customer service
- The full costs of price and volume risk
- The cost of all reporting requirements, e.g., preparing and distributing the disclosure label
- All supply-related costs (including supplier credit costs)
- Renewable Portfolio Standards compliance costs
- An allocation of billing costs
- An allocation of utility overheads (if the utility is the default service provider)
- Charges to reconcile default service costs with revenues
- The effects of locational marginal pricing ("LMP")

The Department should include all generation and retailing costs in the Default Service price as soon as possible. The Department should immediately remove from distribution rates all such costs that can be identified and calculated today and place those costs in default service prices. The Department should initiate a proceeding to identify and allocate the remaining costs.[3]

Even if the Restructuring Act is interpreted to require that the utilities continue to perform certain functions, the costs of those functions can be shifted to the generation price. The utilities should perform the functions as a service to competitive suppliers,

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[3] The New York Public Service Commission has undertaken just such a proceeding. See Order Directing Expedited Consideration of Rate Unbundling, NY PSC Case 00-M-0504 (March 29, 2001). For the interim, New York has established backout credits for functions such as metering, billing, and customer service, which may be modified at the conclusion of the unbundling proceeding. See, e.g., Joint Proposal, NY PSC Case 01-M-0075, Petition of Niagara Mohawk and National Grid for Approval of Merger, at 45 – 46 (October 11, 2001); Order Establishing Uniform Retail Access Billing and Payment Processing Practices, NY PSC 99-M-0631 and 98-M-1343 at 11 – 13 (May 18, 2001) ("Any values established here . . . will be subject to modification as a result of our rate unbundling proceeding.")

including the default service suppliers, and should charge suppliers for the services under Department-approved tariffs.

B. The Utility Should Exit the Role of Default Service Provider.

The second essential step is for the utility to exit the role of default service provider.

To date, retailers have been asked to compete against a stacked deck – one where the utilities have been dealt not only the best cards (customers), but indeed have been dealt all the cards (customers). The Department must shuffle the deck to make default service "compatible with the development of an efficient competitive market." Order Opening Investigation into the Provision of Default Service, D.T.E. 02-40 at 1 (June 21, 2002).

The Department has the authority to remove the utility from the default service role by designating one or more "alternate default service providers" pursuant to M.G.L. c. 164, § 1B(d). One way to select such providers is through a retail auction of default service customers. However, to be effective, the auction must be a true retail auction, where the alternate default service providers assume all generation and retail functions. Otherwise, the "retail" auction would in fact be just one more wholesale procurement, and would not enable the development of a competitive retail market.

C. Make Billing Competitive.

In the end-state, competitive retail suppliers should do the billing. The bill is the primary means of communication with small customers; it should be provided by the competitive firm, not the monopoly. In light of current statutory limitations, the utilities should continue to perform billing for the short term. However, they should do so as a service to suppliers, including default providers, and should charge for that service pursuant to Department-approved tariffs.

D. Reform Default Service Pricing.

The current system of default service pricing features two pricing options: 1) monthly prices that are set in 6-month strips; and 2) a price that is flat for 6 months, calculated as the weighted average of the monthly prices. The first option is working well, especially for large and medium customers. The second option is not working well because of the true-up charge for customers that switch to competitive supply.

The monthly price option works well for large and medium customers. The approach provides some certainty regarding future prices, which benefits both customers and competitive suppliers, and also creates opportunities for suppliers to compete effectively by offering a fixed-price contract.

By contrast, the flat price option is working less well because of the true up charge for customers that switch to competitive supply during a six-month period. The charge creates customer confusion and dissatisfaction. Indeed, many customers view it as a switching penalty. As a result, it creates a barrier to switching.

There are two ways that the Department could solve the problems created by the true-up charge. The Department could eliminate the flat price option altogether. Or, the Department could preserve the flat price option, but eliminate the true-up charge. Either approach would be better than the system in place today.

IV. Responses to Proposals of other Parties.

A. Division of Energy Resources

Recognizing that "as presently procured and priced, Default Service is a significant impediment to the timely development of competitive options for mass-market customers" (DOER comments at 12), DOER has proposed a series of reforms to Default Service. Unfortunately, in some areas the DOER proposal does not go far enough, and in others it would likely exacerbate the very problems that DOER has identified.

First, DOER proposes to shift certain utility costs into the default service price. DOER characterizes these costs as "the avoidable costs associated with the provision of Default Service" and defines them as including "the power supply component of [the] uncollectibles expense" and "the personnel and overhead costs of power supply procurements." DOER comments at 26 and n. 21.

While moving these costs into the Default Service price would be a step in the right direction, it stops well short of the much more comprehensive unbundling necessary to enable retail competition.

Second, DOER proposes to switch from single, short-term wholesale procurements of default service supply to a staggered series of two-year procurements.

Unfortunately, this change would actually harm the competitive market. The staggered procurements would insulate default service prices from market conditions. Under the current system, default prices are brought back in line with the market every six months, or at most every twelve months. Under the DOER proposal, default service would always be out of step with the market, since it would always reflect a blend of prices, some of which would be two years out of date.

Obviously, this would be most problematic when market prices rise, putting the default service price "underwater." Today, this problem is corrected within 6 months. Under the DOER plan, default prices could remain underwater much longer.

A third element of the DOER proposal is for each wholesale default service supplier to be designated as the "Power Supply Representative" for a portion of the distribution company's customers. However, the relationship would be only a virtual one: customers would not be switched to the supplier, and the supplier would not be responsible for the loads of those individual customers.

While well intended, this fiction is likely to create more confusion than benefit. It would create the appearance of a relationship between the supplier and the customer that would not in fact exist.

B. Massachusetts Electric

Massachusetts Electric has proposed what it terms a "retail" auction of its default service customers. As the Competitive Retail Suppliers discussed in our initial comments, a **true** retail auction would be a key component of an effective strategy to enable retail competition.

Unfortunately, the Massachusetts Electric proposal is a "retail" auction in name only. Most significantly, the proposal now contains a "wholesale procurement option," under which wholesale providers could provide default service without assuming any retail responsibilities, and without even switching the retail customers. By enabling wholesale providers to bid a wholesale product, Massachusetts Electric has effectively excluded retail companies. As a result, the auction proposal would do nothing to bring retailers to Massachusetts and nothing to stimulate the competitive retail market for small customers.

Even ignoring the "wholesale procurement option," the Massachusetts Electric proposal would transfer no retail functions to the competitive default service providers. Thus, it does not satisfy the minimum criteria for a true retail auction.

C. PG&E National Energy Group

PG&E National Energy Group ("PG&E") has offered a ballot proposal. Under this approach, the utility would exit the default service role, and competitive suppliers would assume that responsibility. Customers would be given a choice of alternate default service providers, and would exercise that choice via a ballot.

As PG&E recognizes, the proposal is at an early stage of development and requires additional detail. The following questions, among others, must be answered before the Department can determine if the proposal has merit.

- Is a choice of provider incompatible with the concept of a "default" provider?
- How should non-choosers be handled?
- Should suppliers be able to limit their offers, e.g., by the length of time they are open and by the amount of load they will accept?
- Should there be a limit on the number of customers that any one supplier can acquire?
- Should suppliers be able to differentiate themselves on factors other than price?
- What happens to customers at the end of the initial term? Do they stay with the supplier that they chose, or do they fall back into the pool for another ballot?

D. Massachusetts Technology Collaborative

The Massachusetts Technology Collaborative ("MTC") argued that, in its current form, Default Service has not enabled the development of a competitive green power market for customers. The MTC points out that green offerings have been a central feature in more successful competitive retail electric markets, but have yet to develop in Massachusetts. The MTC recommends two alternative approaches to remedy this shortcoming: either the Department should require utility default service providers to offer a green power option; or, the Department should remove the utility from the role of default provider, and allow competitive suppliers to serve that function, thereby enabling the competitive market to develop and offer green products.

The competitive retail suppliers support the MTC's proposal to remove the utility from the role of default service provider. As the MTC suggests, this would foster the development of the competitive retail market, which would respond with green products and other innovative offerings for customers. MTC's alternative proposal, requiring a green utility default service offering, should be rejected. Default service should be a single, plain vanilla offering; the competitive market should provide the other options, including green options.

V. Conclusion

The Competitive Retail Suppliers respectfully request that the Department do the following:

1. Move all generation and retailing costs into the default service price. Open a proceeding to identify and allocate all such costs that cannot be identified and allocated immediately.
2. Remove the utility from the role of default service provider by designating alternative default service providers pursuant to M.G.L. c. 164, § 1B(d), and enable those providers to perform all generation and retail functions.

3. Recognize that billing should become a competitive function in the end-state. In the interim, direct the utilities to perform billing as a service to competitive suppliers – including default providers – under tariffs approved by the Department.
4. Eliminate the true-up charge for default service customers that switch to competitive supply.

Respectfully submitted,

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